

**NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2002**

NOTE 9 – RISK MANAGEMENT

As a municipal organization, the County has a wide range of loss exposures.

The County uses three internal service funds to account for and finance property/casualty, workers' compensation, and employee medical and dental benefits self-insurance programs. Unemployment liability, excluding that related to Public Transportation and Water Quality Enterprises, is accounted for in the funds with loss experience and as governmental long-term debt. The County contracts with a plan administrator to process medical and dental claims. County fund/claims managers, together with the Civil Division of the King County Prosecuting Attorney's Office, are responsible for processing all tort and workers' compensation claims.

Claims settlements and loss expenses are accrued in the three internal service funds for the estimated settlement value of both reported and unreported claims. These funds are responsible for collecting interfund premiums from insured funds and departments, for paying claim settlements and for purchasing certain policies. Interfund premiums are assessed on the basis of claims experience and are reported as revenues and expenses or expenditures.

Insurance Fund

The Insurance Fund, an internal service fund, accounts for the County's property/casualty program. The Fund, established in 1977, accounts for the County's exposures to loss due to the tortious conduct of the County which include those that are commonly covered by general liability, automobile liability, police professional, directors and officials, errors and omissions, and professional malpractice insurance policies. The estimated liability for probable self-insurance losses (reported and unreported) recorded in the fund at December 31, 2002, is \$43,247,000.

The County has been able to purchase insurance to cover property loss exposures but is self-funding the first \$5 million of any one loss for most general liability, automobile liability, police liability, directors and officials, errors and omissions, and Health Department professional malpractice exposures.

Since October 1, 1995, the County has purchased excess liability coverage that provides \$50 million in limits above the \$5 million per occurrence self-insured retention. Prior to 1995, the County's excess liability policy limits were \$20 million and the former Metro government policy limits were \$45 million. Effective August 1, 1997, the County increased limits to \$75 million above its \$5 million self-insured retention. Effective September 1, 1998, the County increased limits to \$100 million above a \$2.5 million per occurrence self-insured retention. The County also purchased property insurance that provided a blanket limit of \$3.3 billion with \$240 million in earthquake and \$150 million in flood limits.

Effective June 1, 2002, the County renewed the property insurance policy with FM Global Insurance Company. This policy has a blanket limit of \$500 million above a \$100,000 per occurrence deductible. FM Global had previously provided a blanket limit equal to the County's total insured values of \$3.2 billion. The event of 9/11 caused property underwriters to pull back on the offering of total insured value blanket limits, as their reinsurers were unable and unwilling to provide the excess limits. The policy provides an overall earthquake sub-limit of \$165 million with an additional earthquake sub-limit of \$75 million for seven buildings (including the Courthouse) identified as having a higher probability of damage in the earthquake. This policy also contains a \$1 million terrorism sub-limit.

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NOTE 9 – CONTINUED

In addition to its property insurance policies and excess liability policy, the County has specific liability insurance policies to cover some of its other exposures. The County has a liability policy for the King County International Airport with policy limits of \$300 million; a property and liability policy to cover the police helicopter activities (with liability limits of \$50 million); and excess coverage for the Workers' Compensation program. The County also has a combined "crime" coverage policy that provides \$5 million in limits with a \$25,000 deductible.

Coverage is provided for protection against loss caused by employee dishonesty; the dishonest acts of third parties in writing or altering checks or other financial instruments; the theft, disappearance and destruction of monies at County locations or when conveyed by a messenger; and for faithful performance of duty. In the past three years, two occurrences have resulted in payments in excess of the self-insured retention. There have been no settlements in excess of the insurance coverage in the prior three years.

During 2002 there were significant changes made in the County's insurance program. The County experienced a significant increase in premiums for excess liability insurance from \$2.185 million to \$3.016 million (on an annualized basis) for \$97.5 million in limits. The substantial increase in premium is attributable to our recent large loss experiences (Aurora Bridge and the Solid Waste landfill cases), the substantial tightening in the insurance marketplace and several recent large outcomes within Washington State involving other governmental entities. The County was able to retain a \$2.5 million per occurrence self-insured retention (SIR) but must satisfy an annual \$1 million "corridor" deductible of \$1 million above our \$2.5 million SIR. (The County must pay an additional \$1 million self-insured retention either from a single large loss or a combination of losses above the County's \$2.5 million deductible.)

In line with the increasing importance of its program of self-insurance, the County has significantly increased funding for the program commensurate with increases in estimated case reserve requirements and incurred-but-not-reported losses. The cash balance in the Insurance Fund has increased from \$2.1 million at December 31, 1985, to more than \$74 million at December 31, 2002.

In addition to funding reserves for known and incurred-but-not-reported cases, the County has adopted a plan to create catastrophic loss reserves to respond to large, non-recurring losses. The catastrophic loss financing program is financed with annual contributions in excess of \$1 million with interest earnings being invested to the benefit of the catastrophic loss reserves. Through December 31, 2002, \$16.4 million of the \$72 million cash balance in the Insurance Fund has been designated for catastrophic loss reserves (see Note 14, "Restriction, Reserves, Designations, and Changes in Equity").

With the assistance of an actuary, the Insurance Fund's claims liability is estimated based upon historical claims experience and other actuarial techniques. Nonincremental claim adjustment expenses are not included as part of the liability. The changes in the Insurance Fund's claims liability in 2001 and 2002 were as follows:

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	Beginning of Year Liability	Current Year Claims and Changes in Estimates	Claim Payments	End-of-Year Liability
2001	\$ 49,191,000	\$ 8,390,564	\$ (11,391,335)	\$ 46,190,229
2002	46,190,229	3,733,558	(6,676,787)	43,247,000

Safety and Workers' Compensation Fund

The Safety and Workers' Compensation Fund, an internal service fund, accounts for the County's self-insurance for workers' compensation as certified under Title 51 RCW, Industrial Insurance Act. Interfund premiums are based on the hours worked by the fund/department-covered employees times an hourly rate that varies for different classes of employees and are recorded as quasi-external interfund transactions. Public Transportation internal fund charges are derived from actuarial projections of their future claims and administrative costs. The estimated liability for probable self-insurance losses (reported and unreported) recorded in the fund at December 31, 2002, is \$15,970,000.

The County purchases an excess workers' compensation policy that provides statutory limits coverage. The amount of loss retained by King County (the self-insured retention) under this policy, effective July 2002, was increased from \$500,000 to \$1,000,000. There has been one settlement in excess of the insurance coverage in the prior three years.

The Fund's claims liability is estimated based on reserves for known claims plus a liability for incurred but unreported claims based on historical experience. Changes in the Safety and Workers' Compensation Fund's claims liability in 2001 and 2002 were:

	Beginning of Year Liability	Current Year Claims and Changes in Estimates	Claim Payments	End-of-Year Liability
2001	\$ 12,420,000	\$ 14,038,600	\$ (13,958,600)	\$ 12,500,000
2002	12,500,000	18,134,233	(14,664,233)	15,970,000

Employee Benefits Program Fund

The Employee Benefits Program Fund, an internal service fund, accounts for employee medical, dental, vision, life, accidental death and dismemberment, and long-term disability benefit programs, except for Public Safety LEOFF retiree medical benefits. There are six insured and two self-insured medical plans. Fifty-one percent of County employees were insured through the two self-insured medical plans. The dental and vision plans are also self-insured. Interfund premiums are determined on a per employee, per month basis and charged to departments through a composite rate of expected claims, expenses and premiums. In some cases, there are employee contributions towards premiums. The estimated liability for probable self-insurance losses (reported and unreported) recorded in the fund at December 31, 2002, is \$11,127,133.

The Fund's claims liability is based on historical experience. Changes in the Employee Benefits Program Fund's claims liability in 2001 and 2002 were:

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	Beginning of Year Liability	Current Year Claims and Changes in Estimates	Claim Payments	End-of-Year Liability
2001	\$ 10,686,287	\$ 59,738,051	\$ (59,662,345)	\$ 10,761,993
2002	10,761,993	72,223,017	(71,857,877)	11,127,133

Unemployment Liability

The County has elected to retain the risk for unemployment compensation payable to former county employees. The State of Washington Employment Security Department bills the County for the unemployment compensation benefits paid to former employees. Expenditures are then recognized in various county funds. In addition, a long-term liability of \$1,531,615 is recorded in governmental long-term debt for the estimated future claims liability for employees as of December 31, 2002.

Changes in governmental long-term debt liability for unemployment compensation in 2001 and 2002 were:

	Beginning of Year Liability	Current Year Claims and Changes in Estimates	Claim Payments	End-of-Year Liability
2001	\$ 1,051,155	\$ 1,534,576	\$ (1,412,968)	\$ 1,172,763
2002	1,172,763	2,204,171	(1,845,319)	1,531,615

Component Unit – Harborview Medical Center

Insurance Fund

Harborview Medical Center (HMC) participates in a self-insurance revolving fund for professional liability coverage through the University of Washington (UW). As of June 30, 2002, the UW did not carry commercial general liability coverage at levels below \$2 million per occurrence. The UW's philosophy with respect to its self-insurance programs is to fully fund its anticipated losses through the establishment of actuarially determined self-insurance reserves. These reserves are deposited in a statutorily created and regulated fund and can only be expended for payment of claim costs and related expenses.

The annual funding to the self-insurance revolving fund is determined by the UW administration based on recommendations from the UW's Risk Management Advisory Committee. The HMC's *pro rata* share of premiums paid to the self-insurance revolving fund were approximately \$924,000 in the period July 1, 2000 to June 30, 2001, and \$1,042,802 in the period July 1, 2001 to June 30, 2002.

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Employee Benefits Program

Term insurance, salary continuation insurance, and a variety of medical insurance plans are available on a group basis to all permanent employees of HMC. The plans are designated and authorized through the State Employees Insurance Board covering all eligible faculty and staff of the public institutions of higher education.

All employees of HMC are covered by Workers' Compensation and Medical Aid Acts for injuries and occupational diseases that occur during the course of their employment. Coverage includes doctors' services, hospital care, ambulance, appliances, compensations for permanent partial and total disability, and allowances and pensions to surviving widows and children in the case of fatal injuries. A majority of the premium cost is paid by the UW and a small deduction is made from the employee's pay to conform with the state law.

Component Unit – WSMLBS Public Facilities District

The Washington State Major League Baseball Stadium Public Facilities District (PFD) carries commercial general liability insurance with a general aggregate limit of \$2 million and a per occurrence limit of \$1 million. In addition, excess liability coverage is in force at aggregate and per event limits of \$5 million. Business automobile liability coverage limit is at \$1 million per any one accident or loss. Commercial personal property losses are covered up to the replacement value not exceeding \$100,000 with separate coverages for earthquake and flood losses.

The PFD also has purchased employee benefit liability coverage with an aggregate limit of \$3 million and a per employee limit of \$1 million.